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HEALTH ANNUAL STATEMENT
FOR THE YEAR ENDING DECEMBER 31, 2007
OF THE CONDITION AND AFFAIRS OF THE

Premier Behavioral Systems of Tennessee, LLC

NAIC Group Code	0000	0000	NAIC Company Code	00000	Employer's ID Number	62-1641638
	(Current Period)	(Prior Period)				
Organized under the Laws of	Tennessee	State of Domicile or Port of Entry	Tennessee			
Country of Domicile	United States					
Licensed as business type:	Life, Accident & Health []	Property/Casualty []	Dental Service Corporation []			
	Vision Service Corporation []	Other []	Health Maintenance Organization []			
	Hospital, Medical & Dental Service or Indemnity []	Is HMO, Federally Qualified? Yes []	No []			
Incorporated/Organized	05/15/1996	Commenced Business	07/01/1996			
Statutory Home Office	222 Second Ave. N. Suite 220	Nashville, TN 37201				
	(Street and Number)	(City or Town, State and Zip Code)				
Main Administrative Office	222 Second Ave. N. Suite 220	Nashville, TN 37201	615-313-4463			
	(Street and Number)	(City or Town, State and Zip Code)	(Area Code) (Telephone Number)			
Mail Address	222 Second Ave. N. Suite 220	Nashville, TN 37201				
	(Street and Number or P.O. Box)	(City or Town, State and Zip Code)				
Primary Location of Books and Records	222 Second Ave. N. Suite 220	Nashville, TN 37201	410-953-1643			
	(Street and Number)	(City or Town, State and Zip Code)	(Area Code) (Telephone Number)			
Internet Website Address	N/A					
Statutory Statement Contact	Michael Fotinos	410-953-1643				
	(Name)	(Area Code) (Telephone Number) (Extension)				
	mdfotinos@magellanhealth.com	410-953-5205				
	(E-mail Address)	(FAX Number)				

OFFICERS

Name	Title	Name	Title
Russell C. Petrella	President	William R. Grimm	Director

OTHER OFFICERS

DIRECTORS OR TRUSTEES

Russell C. Petrella	William R. Grimm	Rene Lerer
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State of Connecticut
County of Hartford ss Curon

The officers of this reporting entity, being duly sworn, each depose and say that they are the described officers of said reporting entity, and that on the reporting period stated above, all of the herein described assets were the absolute property of the said reporting entity, free and clear from any liens or claims thereon, except as herein stated, and that this statement, together with related exhibits, schedules and explanations therein contained, annexed or referred to is a full and true statement of all the assets and liabilities and of the condition and affairs of the said reporting entity as of the reporting period stated above, and of its income and deductions therefrom for the period ended, and have been completed in accordance with the NAIC Annual Statement Instructions and Accounting Practices and Procedures manual except to the extent that: (1) state law may differ; or, (2) that state rules or regulations require differences in reporting not related to accounting practices and procedures, according to the best of their information, knowledge and belief, respectively. Furthermore, the scope of this attestation by the described officers also includes the related corresponding electronic filing with the NAIC, when required, that is an exact copy (except for formatting differences due to electronic filing) of the enclosed statement. The electronic filing may be requested by various regulators in lieu of or in addition to the enclosed statement.

Russell C. Petrella	William R. Grimm
President	Director

Subscribed and sworn to before me this
2nd day of April, 2008

RAYMONDE A. PELLETIER
NOTARY PUBLIC
MY COMMISSION EXPIRES AUG. 31, 2008

a. Is this an original filing? Yes [] No [X]
b. If no,
1. State the amendment number 1
2. Date filed _____
3. Number of pages attached _____

STATEMENT AS OF ANNUAL STATEMENT FOR THE YEAR 2007 OF THE Premier Behavioral Systems of
Tennessee, LLC

UNDERWRITING AND INVESTMENT EXHIBIT

PART 3 - ANALYSIS OF EXPENSES

	Claim Adjustment Expenses		3 General Administrative Expenses	4 Investment Expenses	5 Total
	1 Cost Containment Expenses	2 Other Claim Adjustment Expenses			
1. Rent (\$ for occupancy of own building).....			165,079		165,079
2. Salaries, wages and other benefits.....			5,937,834		5,937,834
3. Commissions (less \$ ceded plus \$ assumed.....)			17,879		17,879
4. Legal fees and expenses.....			68,166		68,166
5. Certifications and accreditation fees.....			511		511
6. Auditing, actuarial and other consulting services.....			723,657		723,657
7. Traveling expenses.....			216,619		216,619
8. Marketing and advertising.....			142,262		142,262
9. Postage, express and telephone.....			265,020		265,020
10. Printing and office supplies.....			716,429		716,429
11. Occupancy, depreciation and amortization.....			2,706,678		2,706,678
12. Equipment.....			4,203		4,203
13. Cost or depreciation of EDP equipment and software.....					0
14. Outsourced services including EDP, claims, and other services.....			(4,773)		(4,773)
15. Boards, bureaus and association fees.....			35,658		35,658
16. Insurance, except on real estate.....					0
17. Collection and bank service charges.....			66,971		66,971
18. Group service and administration fees.....					0
19. Reimbursements by uninsured plans.....					0
20. Reimbursements from fiscal intermediaries.....					0
21. Real estate expenses.....					0
22. Real estate taxes.....			3,152		3,152
23. Taxes, licenses and fees:					
23.1 State and local insurance taxes.....			1,675		1,675
23.2 State premium taxes.....			2,512,912		2,512,912
23.3 Regulatory authority licenses and fees.....					0
23.4 Payroll taxes.....					0
23.5 Other (excluding federal income and real estate taxes).....			190,864		190,864
24. Investment expenses not included elsewhere.....					0
25. Aggregate write-ins for expenses.....	0	1,298,142	0	0	1,298,142
26. Total expenses incurred (Lines 1 to 25).....	0	1,298,142	13,770,796	0	(a) 15,068,938
27. Less expenses unpaid December 31, current year.....			151,865		151,865
28. Add expenses unpaid December 31, prior year.....	0	0	87,467	0	87,467
29. Amounts receivable relating to uninsured plans, prior year.....	0	0	0	0	0
30. Amounts receivable relating to uninsured plans, current year.....					0
31. Total expenses paid (Lines 26 minus 27 plus 28 minus 29 plus 30).....	0	1,298,142	13,706,398	0	15,004,540
DETAIL OF WRITE-INS					
2501. Claims processing expense allocated from parent.....		1,298,142			1,298,142
2502.					
2503.					
2598. Summary of remaining write-ins for Line 25 from overflow page.....	0	0	0	0	0
2599. Totals (Line 2501 through 2503 plus 2598)(Line 25 above).....	0	1,298,142	0	0	1,298,142

(a) Includes management fees of \$ 11,683,275 to affiliates and \$ 0 to non-affiliates.

✓ amended as instructed in letter dated 3/28/08, LH 5/2/08

NOTES TO FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies

A. ACCOUNTING PRACTICES

The accompanying financial statements of Premier Behavioral Systems of Tennessee, LLC. ("PBS" or the "Company") have been prepared in conformity with the National Association of Insurance Commissioners (NAIC) Annual Statement Instructions, the NAIC Accounting Practices and Procedures Manual and the accounting practices prescribed or permitted by the State of Tennessee Department of Commerce and Insurance, which represents a comprehensive basis of accounting other than generally accepted accounting principles (GAAP).

The Company prepares its statutory financial statements in conformity with accounting practices prescribed or permitted by the State. Effective January 1, 2001, the State required that insurance companies domiciled in the State of Tennessee prepare their statutory basis financial statements in accordance with the NAIC *Accounting Practices and Procedures* manual – Version effective January 1, 2001 subject to any deviations prescribed or permitted by the State of Tennessee insurance commissioner.

B. USE OF ESTIMATES IN PREPARATION OF THE FINANCIAL STATEMENTS

The preparation of financial statements in conformity with Statutory Accounting Principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities. It also requires disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the period. Actual results could differ from those estimates.

C. ACCOUNTING POLICY

1. CASH AND SHORT TERM INVESTMENTS: Cash and short-term investments consist of cash on hand and in banks, along with commercial paper whose maturities at time of acquisition were one year or less and whose carrying value approximate their fair market value.
2. INVESTMENTS: Investment securities at December 31, 2007, consist of two U.S. Treasury Notes whose maturities at time of acquisition were less than one year and whose carrying value approximates the fair market value.
3. COMMON STOCK: Not applicable.
4. PREFERRED STOCK: Not applicable.
5. MORTGAGE LOANS: Not applicable.
6. LOAN BACKED SECURITIES: Not applicable
7. INVESTMENTS IN SUBSIDIARIES: Not applicable
8. INVESTMENTS IN JOINT VENTURE: Not applicable
9. ACCOUNTING POLICY FOR DERIVATIVES: Not applicable
10. INVESTMENT INCOME IN PREMIUM DEFICIENCY RESERVE CALCULATION: Not applicable
11. MEDICAL CLAIMS PAYABLE: The liability for medical claims payable includes estimated medical costs as of December 31, 2007 and expenses necessary to cover the ultimate net costs of investigating and settling all claims. The estimated medical claims payable includes the accumulation of estimates for claims reported prior to year-end and estimates of claims incurred but not reported.

Medical claims payable is computed in accordance with generally accepted actuarial practices and is based upon authorized healthcare services and past claims payment experience, together with historical utilization experience and management judgment. Estimates are monitored and reviewed and, as settlements are made or estimates are adjusted, differences are reflected by the Company in current operations.
12. PHARMACEUTICAL REBATE RECEIVABLES: Not applicable
13. REVENUE AND PREMIUMS RECEIVABLE: Capitation payments are recognized as revenue in the month due to the Company. The State of Tennessee TennCare mental health services program ("TennCare") retains a one month withhold – currently at 2.5% - on premiums paid to Premier pursuant to Section 4.7.2 of the Provider Risk Contract (the "Contract"). The purpose of this withhold is to assure the Contractor's compliance with all terms and conditions of the Contract. Additionally, retroactive membership adjustments are paid over a twelve month period. As these retroactive membership adjustments are material to the Company's results, the Company records an estimated receivable, based on historical payment patterns. This receivable is included as a component of Uncollected Premiums in the accompanying financial statements.

Per Section 4.7.1.2 of the Contract, the Company elected to participate in a profit/loss risk banding arrangement with the State of Tennessee. Effective January 2002, the company elected to use profit/loss risk banding option 2, under which losses up to ten percent are shared equally by the Company and the State ("option 2"). In January 2003, the company changed its election to Option 4, under which the states absorbs 100% of profits and losses. Effective January 2006, the profit/loss risk banding terms between the Company and the State were amended. Under the terms of the amendment, the Company and the State share gains above a medical loss ratio of 85% and losses above a medical loss ratio of 91%, equally. Risk share revenue is recognized on a monthly basis consistent with the applicable

NOTES TO FINANCIAL STATEMENTS

terms. The receivable related to the profit/loss risk banding is evaluated monthly, based on current estimates of medical costs. Based on this review, any required adjustment for prior period risk share revenue is recognized.

Note 2 - Accounting Changes and Corrections of Errors

- A. During 2007, there were no material changes in accounting principle and/or correction of errors.

Note 3 - Business Combinations and Goodwill

- A. Statutory Purchase Method – Not applicable.
- B. Statutory Merger - Not applicable.
- C. Assumption Reinsurance - Not applicable.
- D. Impairment Loss - Not applicable.

Note 4 - Discontinued Operations

Not applicable.

Note 5 - Investments

- A. Mortgage Loan, including Mezzanine Real Estate Loans – Not applicable.
- B. Debt Restructuring – Not applicable.
- C. Reverse Mortgages – Not applicable.
- D. Loan Backed Securities – Not applicable.
- E. Repurchase Agreements – Not applicable.
- F. Real Estate – Not applicable.
- G. Investments in low-income tax credits – Not applicable.

Note 6 - Joint Ventures, Partnerships and Limited Liability Companies

The Company does not have any Investments in Joint Ventures, Partnerships, or Limited Liability Companies.

Note 7 - Investment Income

No investment income was excluded from Surplus.

Note 8 - Derivative Instruments

- A. Market risk, credit risk and cash requirements of the derivative – Not applicable.
- B. Objectives for using derivatives – Not applicable.
- C. Accounting policies for recognizing and measuring derivatives used – Not applicable.
- D. Net gain or loss recognized in unrealized gains and losses during the reporting period representing the component of the derivative instruments gain of loss – Not applicable.
- E. Net gain or loss recognized in unrealized gains and losses during the reporting period resulting from derivatives that no longer qualify for hedge accounting – Not applicable.
- F. Derivatives accounted for as cash flow hedges of a forecasted transaction – Not applicable.

Note 9 - Income Taxes

No provision has been made for federal and state income taxes since such taxes are the responsibility of the individual members.

Note 10 - Information Concerning Parent, Subsidiaries and Affiliates

- A. Nature of relationship -

The Company was organized in May 1996 by Premier Holdings, Inc (a wholly-owned subsidiary of AdvoCare), Columbia Behavioral Health, LLC ("CBH") and Managed Health Network, Inc. ("Foundation") for the purposes of contracting with the State of Tennessee Department of Mental Health and Mental Retardation to deliver mental health and substance abuse services to participants of TennCare. The contract was effective and operations of the Company commenced July 1, 1996 with the contract, as amended, ending on June 30, 2008. The State, at its discretions, may terminate the contract prior to June 30, 2008 provided it gives the Contractor sixty (60) days notice.

In September 1997, the Company amended and restated its operating agreement by and between Premier Holdings, Inc and CBH whereby each of these entities would have both financial and governance rights equal to 50%. On

NOTES TO FINANCIAL STATEMENTS

April 11, 2006, Premier Holdings, Inc, purchased Columbia Behavioral Health, LLC.'s fifty percent ownership interest in the Company. As of April 1, 2006, Premier Holdings, ultimately a fully owned subsidiary of Magellan Health Services, has full ownership interest in the Company. The transaction was approved by the Department of Commerce and Insurance.

The State generally regulates the Company as a Health Maintenance Organization and the Company was licensed during October 2002 as a prepaid limited health service organization. The Company's contract with the State represents its only customer.

Magellan was required to implement the provisions of fresh-start reporting, as prescribed by the American Institute of Certified Public Accountants' Statement of Position 90-7, *Financial Reporting by Entities in Reorganization under the Bankruptcy Code*. The effects of Magellan's adoption of fresh-start reporting did not impact the Company's financial statements.

- B. Description of transactions – The Company generally has the following transactions with affiliated entities:
 - a. Accounts payable paid by the parent (Magellan Health Service) - \$675,782
 - b. Management fees paid to Magellan and AdvoCare of Tennessee ("AdvoCare") – see F. below description and amounts.
- C. Dollar amount of transactions – see B
- D. Amounts due to/from related parties – Balances as of December 31, 2007
 - a. Due to Magellan – (\$125,264)
 - b. Due to Advocare – (\$115,995)
 - c. Due from Premier - \$40,618
- E. Guarantees or undertakings for benefit of affiliate – Not applicable.
- F. Material management or service contracts and cost sharing arrangements with related parties –

The Company contracts with AdvoCare of Tennessee, Inc. ("AdvoCare"), a related party, to manage the operations, administrative services and clinical services related to the provision of all mental health benefits, to provide case management services and to arrange primary care and outpatient services. For the year ended December 31, 2007, the Company incurred expense of approximately \$10,385,133 related to these services.

The Company contracts with Magellan Behavioral Health Systems, LLC. to process and pay medical claims. For the year ended December 31, 2007 the Company incurred expense of approximately \$1,298,142 related to these services.

- G. Common ownership or control – Not applicable.
- H. No significant change
- I. Investment in SCA that exceeds 10% - Not applicable.
- J. Investments in impaired SCA entities – Not applicable.
- K. Investment in a foreign insurance subsidiary – Not applicable.
- L. Investment in downstream noninsurance company – Not applicable.

Note 11 - Debt

The Company does not have any debt.

Note 12 - Retirement Plans, Deferred Compensation, Post employment Benefits and Compensated Absences and Other Postretirement Benefit Plans

- A. Defined Benefit Plan – Not applicable.
- B. Defined Contribution Plans – Not applicable.
- C. Multiemployer Plan – Not applicable.
- D. Consolidated/Holding Company plans – Not applicable.
- E. Post-employment Benefits and Compensated Absences – Not applicable.

Note 13 - Capital and Surplus, Shareholders' Dividend Restrictions and Quasi-Reorganizations

The Company must establish and maintain a net worth and working capital which is the greater of either the amount as required by applicable statute; or four percent (4%) of the first one hundred fifty million dollars (\$150,000,000) of annual projected premium revenue plus one and one half percent (1.5%) of annual projected premium revenue over one hundred fifty million dollars (\$150,000,000) where net worth is calculated as net admitted assets in excess of liability as reported in accordance with statutory accounting principles. The Contractor shall establish and maintain the net worth and working capital balances required by applicable statute throughout the term of the contract. As of December 31, 2007, based on 2007 revenues, the Company's net worth requirement is \$4,978,291. The Company is in compliance with this requirement.

On June 26, 2007, TDCI approved a Form D Prior Notice of Transaction filing for the distribution of equity in the amount of \$24,000,000. The distribution of equity to the parent company was completed on July 3, 2007.

Note 14 - Contingencies

The Company is party to various other legal proceedings incidental to its business. In the opinion of management, any ultimate liability with respect to these actions will not materially affect the financial position or results of the Company.

NOTES TO FINANCIAL STATEMENTS

The Company is covered under Magellan's professional liability insurance. Coverage is limited to the period in which a claim is asserted, rather than when the incident giving rise to such claim occurred. Management has the intent to renew the insurance coverage, and historically has been able to renew such coverage. In the event Magellan was unable to obtain professional liability insurance at the expiration of the current policy period, it is possible that the Company would be uninsured for claims asserted after the expiration of the current policy period. The claims-made policy has been renewed through June 17, 2008.

Note 15 - Leases

- A. Lessee Operating Lease – Not applicable.
- B. Lessor Leases and Leveraged Leases – Not applicable.

Note 16 - Information About Financial Instruments With Off-Balance Sheet Risk and Financial Instruments With Concentrations of Credit Risk

The Company does not have any financial instruments with off-balance sheet risk. Certain financial instruments potentially subject the Company to concentrations of credit risk. These financial instruments consist primarily of cash and cash equivalents, investments and uncollected premiums. The Company maintains its cash and cash equivalents with what it believes to be high quality financial instruments. The fair value of the Company's investments is substantially equivalent to their carrying value and, although there is some credit risk associated with these investments, the Company believes the risk to be minimal. The Company's uncollected premiums as of year-end are current.

Note 17 - Sale, Transfer and Servicing of Financial Assets and Extinguishments of Liabilities

- A. Transfers of Receivables reported as Sales – Not applicable.
- B. Transfer and Servicing of Financial Assets – Not applicable
- C. Wash Sales – The Company has not engaged in any Wash Sales during the current calendar quarter or year.

Note 18 - Gain or Loss to the Reporting Entity from Uninsured Plans and the Uninsured Portion of Partially Insured Plans

- A. ASO Plans – Not applicable.
- B. ASC Plans – Not applicable
- C. Medicare of Similarly Structured Cost Based Reimbursement contract – Not applicable.

Note 19 - Direct Premium Written/Produced by Managing General Agents/Third Party Administrators

Not applicable

Note 20 - Other Items

- A. Extraordinary items – Not applicable.
- B. Troubled Debt Restructuring: Debtor – Not applicable
- C. Other Disclosures –
 - a. On July 26, 2006, TennCare announced the managed care organizations which were awarded the contracts to provide integrated behavioral and physical health services in the Middle Region of the State. Since the Company was not a party to either of the contract awards, effective April 1, 2007, the Company will ceased providing services to TennCare members in the Middle region.
- D. Uncollectible balance for assets covered under SSAP No. 6, SSAP No. 47, and SSAP No. 66 – Not applicable.
- E. Business Interruption Insurance Recoveries – Not applicable..
- F. State Transferable Tax Credits – Not applicable.
- G. Amount of deposits admitted under Section 6603 of Internal Revenue Service Code – Not applicable
- H. Hybrid Securities – Not applicable.

Note 21 - Events Subsequent

In January, TennCare issued an RFP seeking to award contracts for the provision of integrated behavioral and physical health services in the East and West Regions of the State. The West Region contract would be effective November 1, 2007 and the East Region contract would be effective January 1, 2009. The winning bidders were announced in April and the Company was not a party to any award.

Note 22 - Reinsurance

- A. Ceded Reinsurance Report – Not applicable.
- B. Uncollectible Reinsurance – Not applicable.
- C. Commutation of Ceded Reinsurance – Not applicable.

NOTES TO FINANCIAL STATEMENTS**Note 23 - Retrospectively Rated Contracts & Contracts Subject to Redetermination**

Not applicable

Note 24 - Change in Incurred Claims and Claims Adjustment Expenses

Changes in reserves for incurred claims and claim adjustment expenses attributable to insured events of prior years are as follows:

Claims unpaid as of January 1, 2007	\$ 15,314,598
Current year claims paid related to prior years	(15,116,916)
Current year change in claims incurred related to prior years	<u>655,100</u>
Claims unpaid as of December 31, 2007 related to prior years	<u>\$ 852,782</u>

Note 25 - Intercompany Pooling Arrangements

Not applicable.

Note 26 - Structured Settlements

Not applicable.

Note 27 - Health Care Receivables

The Company has certain health care receivables generated in the normal course of doing business. As of December 31, 2007, the Company has no health care receivables. Any such receivables are accounted for consistently with the appropriate NAIC regulations.

Note 28 - Participating Policies

Not applicable.

Note 29 - Premium Deficiency Reserves

Not applicable.

Note 30 - Anticipated Salvage and Subrogation

Not applicable.